

**Imminent Assessment Statute Expiration
Cases for Exempt Organizations Are
Adequately Monitored, but Management Can
Better Adhere to Controls at the Group Level**

June 2003

Reference Number: 2003-10-137

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

June 26, 2003

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report – Imminent Assessment Statute Expiration
Cases for Exempt Organizations Are Adequately Monitored, but
Management Can Better Adhere to Controls at the Group Level
(Audit # 200310005)

This report presents the results of our review to determine the adequacy of Exempt Organizations (EO) Examination statute controls to protect the Federal Government's interest in making tax assessments. This audit was initiated in response to a request from the Director, EO, after additional tax resulting from the revocation of an organization's tax-exempt status was not timely assessed by EO Examination personnel. The Director, EO, requested the Treasury Inspector General for Tax Administration's assistance in evaluating the process used to close EO Examination cases and assessing the risk that examination results may not be timely assessed during the closing process.

In summary, we found that EO Examination management in four selected groups obtained and adequately reviewed the primary Audit Information Management System (AIMS) report listing the assigned cases with impending assessment statute expiration dates (ASED). If all EO Examination groups are reviewing this AIMS report as required, there is a low risk of improper statute expiration for cases controlled on the AIMS.

In addition, we reviewed 867 EO Examination cases and determined that 839 did not involve an ASED that had improperly expired. For the remaining 28 cases, insufficient information was available to determine if the statute was protected or had improperly expired. However, we determined that EO Examination group management did not always follow two controls designed to monitor cases with impending ASED expiration that are in the physical inventory of the groups. Specifically, Notices of Statute Expiration (Forms 895) were not always prepared or reviewed timely, and Statute

Expiration Case Notice folders (Forms 10364-A) were not consistently used to alert management of cases with impending statute expiration. These controls are necessary because all cases in EO Examination inventory may not be controlled on the Internal Revenue Service's (IRS) computer system.

We recommended that EO Examination management re-emphasize the requirement to timely complete and review Forms 895 and use Form 10364-A for all cases with imminent ASEDs.

Management's Response: IRS management agreed with our recommendation. The Director, EO Examination, re-emphasized the requirement to timely complete and review Forms 895 and use Forms 10364-A for all cases with imminent ASEDs. Area Managers will review compliance with this requirement during operational reviews. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

Table of Contents

Background Page 1

Management Should Adhere to Established Controls to Monitor
Imminent Statute Expiration Cases in Group Inventory Page 2

Recommendation 1: Page 4

Appendix I – Detailed Objective, Scope, and Methodology Page 5

Appendix II – Major Contributors to This Report..... Page 6

Appendix III – Report Distribution List Page 7

Appendix IV – Management’s Response to the Draft Report Page 8

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

Background

The mission of the Exempt Organizations (EO) Examination program is to identify and correct noncompliance with applicable tax laws. EO Examination personnel conduct examinations to determine whether an exempt organization is organized and operating in accordance with its exempt purpose, is liable for any applicable tax, and has properly filed all applicable returns. Statute controls are designed to protect the Federal Government's interest by ensuring that proposed tax deficiencies are assessed before the expiration of the statute of limitations. The Internal Revenue Code states that, generally, the amount of any tax imposed shall be assessed within 3 years after the return is filed. Assessment statute expiration dates (ASED) are identified to show when the tax must be assessed.

Currently, there are more than 1.5 million exempt organizations that control assets of over \$2 trillion. EO Examination closed 5,278 tax returns during Fiscal Year (FY) 2002 and estimates that 6,500 tax returns will be closed during FY 2003.

This audit was initiated in response to a request from the Director, EO, after additional tax resulting from the revocation of an organization's tax-exempt status was not timely assessed by EO Examination personnel. The Director, EO, requested the Treasury Inspector General for Tax Administration's (TIGTA) assistance in evaluating the process used to close EO Examination cases and assessing the risk that examination results may not be timely assessed during the closing process. We previously conducted a review of the case closing process and determined that EO Examination cases were accurately and timely closed.¹ This audit focused on EO Examination statute controls.

Our audit work was conducted at the EO Examination and Mandatory Review offices located in Dallas, Texas; Brooklyn, New York; North Highlands and Monterey Park, California; and Baltimore, Maryland. Our

¹ *The Exempt Organizations Examination Support Section Accurately and Timely Processed Closed Examinations, but Controls Over Case Receipt Can Be Improved* (Reference Number 2003-10-065, dated February 2003).

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

**Management Should Adhere to
Established Controls to Monitor
Imminent Statute Expiration
Cases in Group Inventory**

work was performed from November 2002 through May 2003 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

We determined that EO Examination management in four selected groups obtained and adequately reviewed the primary Audit Information Management System (AIMS) report² listing the assigned cases with impending ASED expiration. If all EO Examination groups are reviewing the AIMS Table 4.0 as required, there is a low risk of improper statute expiration for cases controlled on the AIMS.

In addition, as shown in Table 1, we reviewed 867 EO Examination cases and determined that 839 did not involve an ASED that had improperly expired. For the remaining 28 cases, insufficient information was available to determine if the statute was protected or had improperly expired.

Table 1: Results of Detailed Case Analysis

Source	Statute Protected ³	Open ⁴	Unable to Determine ⁵	Total Sample Size
October 2002 AIMS Table 4.0	217	125	12	354
2002 AIMS Inventory Validation Listing of Uncontrolled Cases	443	54	16	513
Total	660	179	28	867

Source: The TIGTA's review of 867 EO examination cases.

² The AIMS Table 4.0 is a monthly report that lists all returns assigned to EO Examination groups in which the statute is due to expire in 180 days or less. EO Examination management is required to review this report to ensure the ASED is accurate and action is taken to ensure the statute does not improperly expire.

³ Actions were taken to ensure the ASED did not improperly expire.

⁴ The ASED had not yet expired, and information in the Internal Revenue Service's (IRS) computer system showed that the cases were still assigned to EO Examination personnel as of April 10, 2003.

⁵ There was not enough information in the case file and/or the IRS' computer system to determine if the statute was protected or had improperly expired.

Imminent Assessment Statute Expiration Cases for Exempt Organizations Are Adequately Monitored, but Management Can Better Adhere to Controls at the Group Level

However, we determined that EO Examination group management did not always follow two additional controls designed to monitor cases with impending ASSED expiration that are in the physical inventory of the groups.

Specifically, we found:

- Notices of Statute Expiration (Form 895) were not always prepared or reviewed timely. Forms 895 were not routinely prepared in two of the four groups reviewed. In the remaining two groups, the Forms 895 were not always completed timely to verify the accuracy of the ASSED. In addition, the group managers were not always initialing the ASSED on the Forms 895 that were prepared, to confirm its accuracy.
- A red file folder, Statute Expiration Case Notice folder (Form 10364-A), was not consistently used in all four groups to alert management of cases with impending statute expiration.

These controls are necessary because all cases in EO Examination inventory may not be controlled on the AIMS. During the 2002 AIMS inventory validation,⁶ EO Examination management identified in the possession of EO Examination groups nationwide approximately 3,200 returns that were not controlled on the AIMS. These returns were physically located in the employees' inventories but not on the AIMS. EO management stated that some returns did not need to be controlled on the AIMS because they were related to the returns under examination and obtained for information only. We statistically sampled 250 of the 3,200 returns to determine if the statute was protected, as indicated in Table 1.

Local EO Examination guidelines state that employees having custody of returns should be notified via Forms 895 of the statute expiration date not less than 270 days before

⁶ To ensure that the information on the AIMS is accurate, each function responsible for open accounts on the AIMS is required at least once during a fiscal year to reconcile the physical inventory of each group to those currently on the AIMS.

Imminent Assessment Statute Expiration Cases for Exempt Organizations Are Adequately Monitored, but Management Can Better Adhere to Controls at the Group Level

statute expiration. The Internal Revenue Manual states that employees should verify the expiration date and return the form to their managers within 10 days of receipt. If the Form 895 is not returned, the manager is responsible for instituting follow-up procedures. In addition, local guidelines state that every case file containing a tax return having a statute expiration date within 240 days should be placed in a Form 10364-A (the red file folder).

Management in one group cited the reorganization of their unit into a centralized function and a large workload as reasons for not using Forms 895 and 10364-A. After we discussed these controls with this manager, he agreed to use Forms 895 and 10364-A as applicable. In another group that primarily handles large case examinations, the manager stated that the AIMS Table 4.0 was the primary control used to monitor imminent ASSED cases and did not believe Forms 895 or 10364-A were necessary for the large case examinations because the manager was familiar with the imminent statute cases in the group's inventory. Managers in the two remaining groups did not always ensure that Forms 895 and 10364-A were timely prepared for all imminent statute cases.

By more effectively using these additional controls, EO Examination management can provide increased assurance that imminent statute cases not controlled on the AIMS are properly identified and any proposed tax is assessed before the statute expires.

Recommendation

1. EO Examination management should re-emphasize the requirement to timely complete and review Forms 895 and use Forms 10364-A for all cases with imminent ASSEDs.

Management's Response: The Director, EO Examination, re-emphasized the requirement to timely complete and review Forms 895 and use Forms 10364-A for all cases with imminent ASSEDs. Area Managers will review compliance with this requirement during operational reviews.

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine the adequacy of Exempt Organizations (EO) Examination statute controls to protect the Federal Government's interest in making tax assessments. The following tests were performed to accomplish this objective:

- I. Determined what controls and procedures are in place at the four sites visited to ensure that the Assessment Statute Expiration Dates (ASED) are protected in EO Examination.
 - A. Interviewed EO Examination employees responsible for protecting ASED cases to identify local procedures and controls and determined the process used to ensure ASEDs are protected.
- II. Determined if EO Examination is effectively protecting ASEDs.
 - A. Reviewed 354 cases (representing 100 percent) at the 4 sites listed with the most imminent statute cases on the October 2002 EO Examination Audit Information Management System (AIMS) Table 4.0¹ and determined if required actions were timely taken in accordance with statute control procedures.
 - B. Determined whether the group managers at the four sites reviewed the monthly AIMS Table 4.0 during Fiscal Year 2002 as required.
 - C. Selected 3 statistical samples of cases totaling 513 cases from the EO Examination 2002 AIMS Inventory Validation Listing that were 1) in the possession of the groups but not controlled on the AIMS or 2) assigned to the groups per the AIMS but not in physical inventory.²

¹ The AIMS Table 4.0 is a monthly report that lists all returns assigned to EO Examination groups in which the statute is due to expire in 180 days or less. EO Examination management is required to review this report to ensure the ASED is accurate and action is taken to ensure the statute does not improperly expire.

² For our first sample, we reviewed all 64 error cases identified by EO Examination personnel. We used an attribute sampling formula to select the other 2 samples, using a 90 percent confidence level, a precision rate of 5 percent, and an expected error rate not to exceed 50 percent. Specifically, we reviewed 199 of 754 and 250 of 3,249 uncontrolled cases identified by EO Examination personnel.

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy Nakamura, Director

Jeffrey M. Jones, Audit Manager

Margaret Anketell, Senior Auditor

Kenneth Forbes, Senior Auditor

Cheryl Medina, Senior Auditor

Donald Martineau, Auditor

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner for Services and Enforcement N:DC
Director, Exempt Organizations, Tax Exempt and Government Entities Division T:EO
Director, Communications and Liaison, Tax Exempt and Government Entities Division T:CL
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

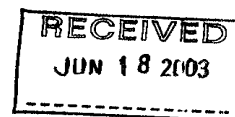
Appendix IV

Management's Response to the Draft Report





DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

JUN 17 2003



MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Evelyn A. Petschek, Commissioner
Tax Exempt and Government Entities 

SUBJECT:  Response to Audit Report: Imminent Assessment Statute
Expiration Cases For Exempt Organizations Are Adequately
Monitored, but Management Can Better Adhere to Controls at
the Group Level (Audit #200310005)

Thank you for the opportunity to respond to your audit concerning the adequacy of Exempt Organizations (EO) Examination statute controls to protect the Federal Government's interest in making tax assessments.

I note with satisfaction that your report did not identify any examination cases at the time of your review in which assessment statute expiration dates (ASED) improperly expired. You also determined that that EO Examination management in four selected groups obtained and adequately reviewed the primary Audit Information Management System (AIMS) report listing all assigned cases with impending assessment statute expiration dates.

We take seriously the fact that EO examination cases must be properly controlled to protect the Federal Government's interest in making tax assessments. We will ensure that EO Examination Management adheres to established controls to monitor imminent statute expiration cases in group inventory. We concur that EO Examination management re-emphasize the requirement to timely complete and review Forms 895 Notices of Statute Expiration, and use Forms 10364-A, Statute Expiration Case Notice, for all cases with imminent ASEDS.

Our comments on the specific recommendations in the report are as follows:

IDENTITY OF RECOMMENDATION 1

The Commissioner, TEGE Division, should ensure that EO Examination management re-emphasize the requirement to timely complete and review Forms 895 and use Forms 10364-A for all cases with imminent ASED.

**Imminent Assessment Statute Expiration Cases for Exempt
Organizations Are Adequately Monitored, but Management
Can Better Adhere to Controls at the Group Level**

- 2 -

ASSESSMENT OF CAUSES

TIGTA found that Forms 895 were not always prepared or reviewed timely, and Forms 10364-A were not consistently used to alert management of cases with impending statute expiration. These controls are necessary because all cases in EO Examination inventory may not be controlled on the Internal Revenue Services computer system.

CORRECTIVE ACTIONS

The Director, EO Examinations, in a staff meeting held on May 15, 2003, re-emphasized the requirement to timely complete and review Forms 895 and use Forms 10364-A for all cases with imminent ASEDs. Area Managers were also directed to cover the requirement with their managers and to review compliance with this requirement during operational reviews.

IMPLEMENTATION DATE

Completed May 15, 2003

RESPONSIBLE OFFICIALS

Director, EO Examinations

CORRECTIVE ACTION MONITORING PLAN

Not Applicable

If you have any questions concerning this response, please call Jim Templeman at (312) 566-3906.